89-845

NO._____

IN THE SUPREME COURT

OF THE UNITED STATES

OCTOBER TERM 1989

ROTHBURY INVESTMENTS, LTD., a Canadian Corporation,

Petitioner

vs.

DURA SYSTEMS, INC., a Pennsylvania Business Corporation,

Respondent

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

Filed by:

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128 pp

QUESTIONS PRESENTED

ISSUE 1: WHETHER THE DECISION OF THE THIRD CIRCUIT EXCUSING THE SANCTIONED LAW FIRM AND ITS INDIVIDUALLY SANCTIONED LAWYERS FROM FILING A NOTICE OF APPEAL DIRECTLY CONFLICTS WITH THE DECISION OF THIS COURT IN TORRES V. OAKLAND SCAVENGER CO. AND THE STRICT REQUIREMENTS OF F.R.A.P. 3(c).

ISSUE 2: WHETHER THE DECISION OF THE THIRD CIRCUIT EVISCERATING PLAINTIFF'S COUNSEL'S DUTY OF "REASONABLE INVESTIGATION" PURSUANT TO F.R.C.P. 11 BY REQUIRING THAT DEFENDANT PROVE TO PLAINTIFF'S COUNSEL'S SATISFACTION DURING THE COURSE OF THE LITIGATION THAT PLAINTIFF'S COUNSEL HAD NO AUTHORITY TO INITIATE OR MAINTAIN THE LITIGATION ON BEHALF OF PLAINTIFF CORPORATION, IS CONTRARY TO F.R.C.P. 11 AND CONFLICTS WITH DECISIONS OF THE THIRD CIRCUIT AND OTHER FEDERAL COURTS OF APPEALS TO SUCH AN EXTENT THAT THE SUPERVISORY POWER OF THIS COURT IS REQUIRED.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Statutes and Rules

I. LIST OF PARTIES

The parties to the Court of Appeals proceeding were:

Dura Systems, Inc., a Pennsylvania Business Corporation, Appellant/Cross-appellee.

Rothbury Investments, Ltd., a Canadian Corporation, Appellee/Cross-appellant.

It is disputed by the Petitioner that the law firm of Eddy & Osterman, Thomas D. Eddy, John D. Eddy and Thomas G. Eddy were properly made parties to the appeal below because they did not file a notice of appeal in their names. However, for purposes of the appeal the court below treated the law firm and the individual lawyers as Appellants/Cross-Appellees.

II. OPINIONS BELOW

The opinion of The Court of Appeals for the Third Circuit is to be reported at 886 F.2d 551 (App. A and B infra).

The opinion of the District Court for the Western District of Pennsylvania C.A. 86-2621, dated October 11, 1988, is unreported (App.C and D infra).

III. STATEMENT OF JURISDICTION

Plaintiff asserted jurisdiction in the district court based upon 28 U.S.C §1332(a) for diversity of citizenship.

The Court of Appeals had jurisdiction based upon Appellant/Cross-appellee's appeal from a final order of the district court pursuant to 28 U.S.C. §1291.

The decision of the court of appeals was entered on September 19, 1989 and the Petition for Rehearing and

Suggestion for Rehearing En Banc was denied on October 13, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

IV. STATUTE INVOLVED

Rule 11 of the Federal Rules of Civil Procedure provides:

> "Every pleading, motion and other paper of a party represented by an attorney shall be signed by at least one attorney of record in the attorney's individual name, whose address shall be stated. A party who is not represented by an attorney shall sign the party's pleading, motion or other paper and state the party's address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath may be overcome by the testimony two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion or other paper is not signed, it shall be

stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion or other paper, including a reasonable attorney's fee."

Fed.R.Civ.Proc. 11

V. STATEMENT OF THE CASE

Thomas R. Eddy, senior member of the Eddy law firm, was a one-third minority shareholder in Plaintiff corporation, Dura Systems, Inc. (141a.). In fact, Thomas R. Eddy was entrusted with the formation of Dura Systems, Inc. by the remaining two (2) shareholder interests. The ownership interests and the entrustment of the formation of the corporation to Thomas R. Eddy were the subject of an agreement between Thomas R. Eddy (one-third interest), Kenneth R. Dehus (one-third interest) and Angelo and Antonio Risi (jointly one-third interest), dated January 29, 1984.

Angelo Risi and his brother, Antonio Risi (hereinafter the Risi's) are the owners of Rothbury Investments, Ltd., a Canadian company which holds various patents and trademarks in the United States and Canada for a concrete retaining

wall system invented by the Risi's. Angelo Risi is the President of Rothbury Investments, Ltd. and is authorized to act on behalf of that company (40a.).

Kenneth R. Dehus is a former client of the law firm of Eddy & Osterman (Dura systems Brief Appeal No. 88-3520 p. 4). Thomas R. Eddy is an attorney and member of the law firm of Eddy & Osterman. Id. Mr. Eddy, Mr. Dehus and the Risi's are shareholders in Dura Systems (10a.-13a.) which was unilaterally controlled by Thomas R. Eddy, acting as a minority shareholder holding only a one-third (1/3) interest at material times to the underlying action (35a.-38a., 40a.-42a., 45a.-48a.).

On January 29, 1984, Eddy, Dehus and the Risi's entered into an agreement to form a corporation called Dura Systems (10a.-13a.). Dura Systems was formed essentially for the purpose of selling

franchises to manufacturers interested in selling the Risi's patented retaining wall products in areas of the United States (10a.-13a.). The agreement specifically provided that the shares of Dura Systems were to be owned one-third (33 1/3%) by the Risi's jointly, one-third (33 1/3%) by Dehus and one-third (33 1/3%) by Eddy (10a.-13a.).

As part of the January 29, 1984 Dura Systems agreement, Thomas R. Eddy, Esquire, was to provide the legal expertise for the formation of the corporation (12a., 36a., 41a., 46a.).

From the time of the signing of the shareholders' agreement in January, 1984, to the date of the affidavits in the record below in 1987, neither Mr. Dehus nor the Risi's received share certificates, notice of any shareholders or directors meetings, an opportunity to elect directors, or the opportunity to

vote to adopt by-laws of the corporation (36a., 41a., 46a.). As indicated by the affidavits in the record, Dura Systems' shareholders, Dehus and the Risi's, were completely excluded by Attorney Eddy from the corporate affairs of Dura Systems from January 29, 1984 until 1987 (35a.-38a., 40a.-43a., 45a.-48a.). During this period of time, Mr. Eddy operated Dura Systems as his alter ego, feeling no need to report or account for his actions to the majority shareholders.

The lawsuit, Dura Systems v. Rothbury Investments, Ltd., brought in the Federal District Court for the Western District of Pennsylvania at C.A. No. 86-2621, and resulting in an appeal to the Court of Appeals for the Third Circuit at No. 88-3520 by Thomas R. Eddy and his law firm were in fact initiated without the knowledge, consent or authorization of the individuals who were to own a sixty-six

and two-third percent (66 2/3%) majority of the shares of Dura Systems pursuant to the parties' agreement (37a., 42a., 47a.). To support Defendant's Motion to Dismiss, the Risi's as owners of Rothbury Investments, Ltd., through defense counsel, exercised their rights as shareholders of Dura Systems to inspect the official corporate documents. To this end, the Risi's presented a petition in the Common Pleas Court of Allegheny County, Pennsylvania, pursuant to the Pennsylvania Business Corporation Law, and obtained a court order permitting the inspection of any and all Dura Systems corporate documents (177a. and in the district court record below see the Affidavit of Clayton A. Sweeney, Esquire, filed May 5, 1987). The Risi's reviewed the Dura Systems corporate documents for the first time in 1987 (180a.). The complete set of corporate documents

received from Dura Systems and Dura Systems' counsel, Eddy & Osterman, were attached to Defendant's reply brief in the court below as Exhibit D and are included in the appendix at 127a.-177a. (see also in the district court record below, the Affidavit of Hunter A. McGeary, Jr., Esquire, filed May 5, 1987). These papers are a complete set of the corporate documents for Dura Systems at least up to the time of the first shareholders' meeting of Dura Systems held in May of 1987.

Review of the Dura Systems corporate documents confirms that Mr. Eddy had no authority to maintain the underlying Dura systems lawsuit (290a.). Thomas R. Eddy used his legal expertise to form Dura Systems as noted in the agreement (12a.), by incorporating Dura Systems himself and electing himself and his two sons, John D. Eddy, Esquire and

Thomas G. Eddy, Esquire, directors of the corporation (136a., 137a.). In fact, it is undisputed in the record that all of the purported corporate documents and actions of Dura Systems were authorized, created and maintained by Thomas R. Eddy, Esquire, John D. Eddy, Esquire and Thomas G. Eddy, Esquire (127a.-177a.), and that the shareholders were never consulted before the shareholder meeting in May, 1987.

Included in the corporate documents are purported minutes of the Eddy board, whereby the one-third minority shareholder, Thomas R. Eddy, together with his two sons, authorized Mr. Eddy's own law firm, Eddy & Osterman, to initiate suit against Rothbury Investments, Ltd., without the notification, consent or authorization of those individuals who were to be shareholders, owning sixty-six and two-third percent (66 2/3%) of the

company shares (171a.-172a.). The lawsuit was initiated by Mr. Eddy and his law firm despite the fact that they had previously been made aware of the Risi's objections to Mr. Eddy's total unilateral control of the company (116a.-118a., 176a.-177a.).

The complete domination and control of Dura Systems, Inc. by its minority shareholder, Thomas R. Eddy, Esquire, is further evidenced by corporate maneuvering that he and his two sons attempted during the pendency of the underlying litigation (173a.-175a.). In an attempt to thwart the will of the majority shareholders and prevent the majority shareholders from conducting business at a shareholders' meeting requested by the majority shareholders in the Spring of 1987, the Eddy-installed board of directors claimed to amend the by-laws which had never been previously adopted by the shareholders. The Eddy amendment

sought to require unanimous consent of the shareholders for any business of the corporation to be conducted at the scheduled shareholders' meeting in an attempt to bootstrap the position which had already been taken by them and so as to perpetuate the unauthorized lawsuit which the Eddy law firm had initiated and maintained. (173a.-175a.).

A shareholders' meeting was held on May 13, 1987, wherein the majority shareholders, Dehus and the Risi's, by proxy, adopted by-laws, elected directors, dismissed the law firm of Eddy & Osterman as legal counsel, appointed Randall McCamey, Esquire, a sole practitioner, as counsel to Dura Systems, directed Attorney McCamey to dismiss the litigation entitled Dura Systems, Inc. v. Rothbury Investments, Ltd., at C.A. No. 86-2621, and further directed Attorney McCamey to

dissolve the corporation itself (197a.-242a.).

After the will of the majority shareholders had been made known at the shareholders' meeting on May 13, 1987, Mr. John D. Eddy, Esquire, proxy holder for minority shareholder, Thomas D. Eddy, stated that: "Mr. Eddy will oppose vehemently and will seek to enjoin the dismissal of this lawsuit by shareholders of the corporation...." (213a.). Indeed Thomas R. Eddy, John D. Eddy, Thomas G. Eddy and the Eddy law firm thereafter deliberately ignored the direction of the shareholders dismissing them as counsel for the Dura Systems corporation. The Eddy law firm and its members thereafter continued to file papers in the district court and then filed an appeal to the Third Circuit Court of Appeals on the merits of C.A. 86-2621 which defendant, Rothbury was forced to defend, incurring

additional legal fees. The appeal on the merits was not merely filed after the shareholders had directed the Eddy firm to withdraw as counsel; it was also filed after defendant, Rothbury had filed its motion for sanctions pursuant to F.R.C.P. 11. Finally, the Eddy law firm and its members appealed the assessment of sanctions against the corporation in a second appeal to the Third Circuit which is now, in part, the basis of the current petition.

The background of the Rule 11 motion itself and the imposition of sanctions should be noted. In his July 1, 1988 order dismissing C.A. 86-2621 on the merits Chief Judge Cohill of the District Court provided the Eddy law firm with an opportunity to respond to Defendant Rothbury's Motion for Fees and Expenses under Federal Rule of Civil Procedure 11 (299a.). Plaintiff's counsel responded and

Judge Cohill filed a further extensive opinion and order dated October 11, 1988 granting Defendant's motion for Rule 11 sanctions (406a.-432a. and Appendix A hereto). Thereafter, pursuant to the District Court's October 11, 1988 order, Defendant's counsel submitted an affidavit of attorney's fees and expenses incurred to that point (433a.). Finally, pursuant to a request by the Eddy law firm, a hearing on the amount of attorney's fees and expenses to be awarded was held before Judge Cohill on December 21, 1988 (446a.-551a.)

Judge Cohill entered an award on December 22, 1988 in Defendant's favor for part of the fees and expenses claimed against Plaintiff, Dura Systems only (552a. and Appendix B hereto). Defendant then moved on December 30, 1988 to have the District Court's award also entered against the Eddy law firm and its members

individually in accordance with Defendant's Rule 11 motion and the District Court's prior order of October 11, 1988 granting Defendant's Motion for Sanctions "against the law firm of Eddy & Osterman under Rule 11 of the Federal Rules of Civil Procedure" (See in the record below, Defendant's Motion to Amend and/or Modify Memorandum Order of December 22, 1988, filed December 30, 1988). Judge Cohill entered an amended order dated January 3, 1989 assessing counsel fees against Plaintiff, the law firm of Eddy & Osterman and its members, Thomas R. Eddy, John D. Eddy and Thomas G. Eddy individually (554a. and Appendix B hereto). From this order, only the Plaintiff-corporation, Dura Systems, Inc., appealed below (555a.).

Rothbury Investments, Ltd. cross-appealed below requesting the Court of Appeals to increase the amount of

attorneys fees awarded based upon evidence of attorney's fees of $30,325 incurred by Defendant Rothbury Investments, Ltd. through December 20, 1988. The amount of fees requested by Cross-Appellant, Rothbury of $30,325 was computed by adding the fees calculation of $24,875 (for fees incurred from the inception of the litigation until October 24, 1988) to the fees calculation of $5,450 (for fees incurred from October 24, 1988 until December 20, 1988, the day immediately prior to the Rule 11 fees hearing before Chief Judge Cohill). See transcript of hearing dated December 21, 1988 and Defendant's Exhibits 1 and 4 (transcript 446a.-487a., Exhibit 1 at 488a.-492a., Exhibits 4 and 5 at 537a.-540a.). Judge Cohill's order of January 3, 1989 granted fees for violation of Rule 11 in the amount of $12,275, representing fees from the day after the May 13, 1987 share-

holders' meeting until the date of the Rule 11 fees hearing (554a. and 538a.-551a and 463a-466a.). Therefore, Defendant Rothbury Investments, Ltd. cross-appealed to the Court of Appeals to obtain sanctions against the Eddy law firm and its members in the amount of $30,325.

ARGUMENT

A. THE PANEL'S DECISION TO EXCUSE LITERAL COMPLIANCE WITH F.R.A.P. 3(c) BY ALLOWING THE EDDY LAW FIRM AND ITS MEMBERS TO APPEAL WITHOUT FILING A NOTICE OF APPEAL SPECIFICALLY IN THEIR OWN NAMES IS CONTRARY TO THE UNITED STATES SUPREME COURT HOLDING IN TORRES V. OAKLAND SCAVENGER COMPANY AND AS SUCH MERITS REVERSAL.

The Third Circuit held that the security agreement filed to insure payment of the District Court's Order was the "functional equivalent" of a notice of appeal for the Eddy law firm and it members. Dura Systems Opinion, page 9. In reaching this conclusion, the Court cited the Advisory Committee note to Federal Rule of Appellate Procedure 3(c) and two cases of the Court of Appeals for the Fifth Circuit. Cobb v. Lewis, 488 F.2d 41 (5th Cir. 1974); Holley v. Capps, 468 F.2d 1366 (5th Cir. 1972). Both of these cases were decided well before the Supreme Court's controlling decision in

Torres v. Oakland Scavenger Company, ____ U.S. ____, 108 S.Ct. 2405, 101 L.Ed. 2d 285 (1988). The Third Circuit also cited non-binding dicta of the Torres Opinion concerning the generally liberal construction of the Rules of Civil Procedure. Dura Systems Opinion, Appeal No.s 89-3005 and 89-3023 at pages 8-9.

Rothbury Investments, Ltd. contends that the reasoning of the panel contradicts binding precedent of this Court. Torres requires that the sanctions order against the law firm of Eddy & Osterman, Thomas D. Eddy, John D. Eddy, and Thomas G. Eddy be upheld for their failure to properly effect an appeal of the Rule 11 Order entered against them. At least one other Court of Appeals has addressed this issue in the context of an attorney's failure to appeal a Rule 11 sanctions order. Federal Trade Commission v. Amy Travel Service, Inc., 1989-1 Trade

Cas. (CCH) P 68,584 (7th Cir. No. 88-2328). In Amy Travel, one of the attorneys sanctioned by the District Court (Bennett) failed to file a notice of appeal along with the other sanctioned lawyer. The Seventh Circuit, in rejecting an argument that an appeal had been perfected, succinctly stated:

> Bennett argues that this Court should exercise discretion and disregard the omission of his name from the notice of appeal. Bennett claims that our decision in Hayes v. Sony Corp. of America, 847 F.2d 412 (7th Cir. 1988), stands for the proposition that the object of the notice of appeal is merely to give opposing parties notice that an appeal has been taken. Bennett states that all parties were aware of the appeal and who the parties in interest were. Bennett argues that no purpose would served by dismissing his appeal for what amounts to a harmless error.
>
> Bennett's reliance on Hayes is mistaken in light of the Supreme Court's decision in Torres, 108 S.Ct. 2405 (1988). In Torres, the Supreme Court healed a split in the circuits by enunciating an unyielding

> interpretation of Federal Rule of Appellate Procedure 3(c) that took away this Court's discretion to waive technical requirements. Bennett is correct that before Torres, 'failure to name each appellant forfeited that party's right to appeal only if there was a danger that the appellee might have been misled by the omission...' Allen Archery, Inc. v. Precision Shooting Equipment, Inc., 857 F.2d 1176, 1176 (7th Cir. 1988) (citing Hayes, 847 F.2d at 414.) However, 'Torres changed the law in this Circuit. It requires us to insist on punctilious, literal and exact compliance...' with Rule 3(c)'s naming requirements. Allen Archery, 857 F.2d at 1177.
>
> Torres made the requirements of Rule 3(c) inflexible. The Rodgers case makes it clear that because the notice of appeal did not name Bennett as the party taking the appeal, we have no jurisdiction over this appeal.

Federal Trade Commission v. Amy Travel Service, Inc., 1989-1 Trade Cas. (CCH) P 68,584 (7th Cir. No. 88-2328) (emphasis added), citing, Rogers v. National Union

Fire Ins. Co., 864 F.2d 557 (7th Cir. 1988).

In the case at bar, the court below improperly invoked its discretion to hold that a security agreement entered into for the purpose of securing payment by the violators of Rule 11 was the "functional equivalent" of a notice of appeal because it was filed within the time for taking an appeal. However, while Rothbury anticipated that the law firm and attorneys sanctioned by the District Court would appeal, and sought a security agreement to protect against that possibility, the security agreement was filed with the Court before the expiration of the appeal period. The remaining appeal period then passed without these individuals taking an appeal. Rothbury's expectations prior to the expiration of the appeal period cannot excuse literal compliance with the appellate rules as

mandated by the Supreme Court and as interpreted and applied by the Seventh Circuit Court of Appeals in circumstances virtually identical to this case. Thus, the appeal should be dismissed as to the law firm of Eddy & Osterman, Thomas D. Eddy, John D. Eddy and Thomas G. Eddy and, at a minimum, the District Court's imposition of sanctions against these individuals should be reinstated regardless of this Court's determination whether to hear the merits of the appeal and cross-appeal of the reversal of Rule 11 sanctions by the Third Circuit Court of Appeals.

B. THE THIRD CIRCUIT DECISION SHIFTS THE BURDEN OF PLAINTIFF'S "REASONABLE INVESTIGATION" TO THE DEFENDANT BY REQUIRING THE DEFENDANT TO PROVE TO PLAINTIFF'S COUNSEL BEYOND ANY DOUBT WHATSOEVER DURING THE LITIGATION THAT THE FILING AND MAINTENANCE OF THE LAWSUIT VIOLATES F.R.C.P. 11. THE THIRD CIRCUIT DECISION IS THEREFORE CONTRARY TO THE LANGUAGE OF THE RULE ITSELF, PREVIOUS DECISIONS OF THE THIRD CIRCUIT COURT OF APPEALS AND OTHER APPELLATE COURTS BECAUSE IT FAILS TO RECOGNIZE THE "AFFIRMATIVE DUTY" OF PLAINTIFF'S COUNSEL TO MAKE A "REASONABLE INVESTIGATION" OF THE FACTS AS REQUIRED BY F.R.C.P. 11.

The Federal Courts of Appeals have consistently imposed an affirmative duty on plaintiff's counsel to make a reasonable pre-filing inquiry as required by the plain language of Rule 11.[1]

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1 See Ballard's Service Center, Inc. v. Transue, 865 F.2d 447 (1st Cir. 1989) ("Plaintiff charged with the duty of reasonable inquiry into the legal legitimacy of a removal to Federal Court."); Cross & Cross Properties, Ltd. v. Everett Allied Co., 886 F.2d 497 (2nd Cir. 1989) ("Sanctions are warranted where...a reasonable inquiry into the basis for

(Footnote 1 Continued on Next Page

Indeed, even previous opinions of the Third Circuit subsequent to the 1983 amendments to F.R.C.P. 11 recognize the affirmative duty of counsel to conduct reasonable investigation before initiating or maintaining litigation. Napier v. Thirty or More Unidentified Federal Agents, 855 F.2d 1080, 1091 (3d Cir. 1988); Lieb v. Topstone Industries, Inc., 788 F.2d 151, 157 (3d Cir. 1986).

> The rule [F.R.C.P. 11] imposes on counsel a duty to look before leaping and may be seen as a litigation version in the familiar railroad crossing admonition to 'stop, look, and listen.'

Lieb v. Topstone Industries, Inc.,

(Footnote 1 Continued from Previous Page)
the pleading has not been made..."); Napier v. Thirty or More Unidentified Federal Agents, 855 F.2d 1080 (3rd Cir. 1988); Cleveland Demolition Co., Inc., V. Azcon Scrap Co., 827 F.2d 984 (4th Cir. 1987); Knight v. Sharif, 875 F.2d 516 (5th Cir. 1989) ("[A]n attorney must comply with the affirmative duties imposed by Rule 11 as to each and every filing with the district court."); Jackson v. O'Hara,
(Footnote 1 Continued on Next Page

788 F.2d at 157.

> To satisfy the affirmative duty imposed by Rule 11, an attorney must inquire into both the facts and the law before filing papers with the court.

Napier, 855 F.2d at 1091 (emphasis added).

In Unioil, Inc. v. E.F. Hutton & Co., 809 F.2d 548 (9th Cir. 1987), the Ninth Circuit considered plaintiff's counsel's duty of reasonable investigation in the corporate context. Specifically, the Ninth Circuit considered plaintiff's counsel's reasonable inquiry into the facts prior to filing suit:

> An attorney violates Rule 11 whenever he signs a pleading,

(Footnote 1 Continued from Previous Page)
Ruberg, Osborne and Taylor, 875 F.2d 1224 (6th Cir. 1989) (attorney obligated to conduct reasonable inquiry to determine that document is well grounded in fact); Teamsters Local 579 v. B & M Transit, Inc., 882 F.2d 274 (7th Cir. 1989) ("A party risks sanction for failing to make a reasonable inquiry into the factual and legal basis for the asserted claim."); Lupo v. R. Rowland & Co., 857 F.2d 482 (8th Cir. 1988)
(Footnote 1 Continued on Next Page

> motion, or other paper without having conducted a reasonable inquiry into whether his paper is frivolous, legally unreasonable, or without factual foundation. An attorney also violates Rule 11 whenever he signs a paper that is filed for a purpose that is improper under an objective standard.

Unioil, 809 F.2d at 557 (emphasis in original). In concluding that plaintiff's counsel in the Unioil case violated Rule 11, the court considered "the circumstances in which he acted." Id. Finding that plaintiff's counsel "had reason to know" of certain facts prior to filing suit, the Ninth Circuit stated:

> Just as the gravity of foreseeable injury is relevant to determining a party's

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(Footnote 1 Continued from Previous Page) (imposition of sanctions based upon full factual record of the case was proper); Unioil, Inc. v. E.F. Hutton & Co., 809 F.2d 548 (9th Cir. 1987); Adamson v. R. Bowen, M.D., 855 F.2d 668, 673 (10th Cir. 1988); United States v. Milam, 855 F.2d 739, 742 (11th Cir. 1988); Westmoreland v. CBS, Inc., 770 F.2d 1168, 1174 (D.C. Cir. 1985).

> standard of care in a negligence case, so should the cost of a foreseeable response by opposing parties be relevant to determining an attorney's standard of reasonable inquiry.

Unioil, 809 F.2d at 557. Moreover, the Ninth Circuit did not require defendants to point out the propriety of the class representation to plaintiff's counsel; rather, it was the duty of plaintiff's counsel "to take reasonable steps to insure that the class claims were represented by a plaintiff independent of Unioil management...." Id. at 558. Based upon the above considerations, the Ninth Circuit found that plaintiff's counsel "had reason to know" that the corporate plaintiffs he represented in that action were not proper class plaintiffs. Id. at 558 (emphasis added). However, in the circumstances of the instant case, as interpreted and applied in the Third Circuit(see parts B1. and B2. infra), the

Rule 11 standard used by the Third Circuit is not what Plaintiff's counsel "had reason to know," but "what Defendants can prove to Plaintiff's counsel" on the record. Thus, by twisting the affirmative duty of a reasonable factual and legal investigation to this extent and in effect shifting the burden of proof to show an inadequate investigation to the Defendants, the Third Circuit has placed its interpretation of F.R.C.P. 11 on a collision course with virtually every other Circuit Court of Appeals in this country (see fn. 1), as well as its own decisions, and the language of Rule 11 itself.

In the current case, the Eddy law firm and its members violated this affirmative duty on two occasions. They deliberately and intentionally ignored the shareholders' instructions at the May 13, 1987 meeting (Section B.1 infra). Further-

more, they conducted no investigation at the time suit was initiated despite the Eddy law firm's knowledge of shareholder dissatisfaction with the law firm's total unilateral control of the Dura Systems corporation at that time (Section B.2 infra). Accordingly, the supervisory power of this Court is required to reverse the decision of the Third Circuit Court of Appeals in this case.

1. **The Eddy law firm and its members were on actual notice as of the May 13, 1987 shareholders' meeting that two (2) of the three (3) shareholders of the close corporation opposed maintenance of the lawsuit. Thus, Plaintiff's counsel had no reasonable basis in fact to believe that the same two individuals, who also constituted a controlling number of the directors of the same corporation, would vote differently if a vote were held by the same individuals acting as directors, and accordingly, the Eddy law firm should have not further pursued the underlying lawsuit.**

In reversing the District Court's award of sanctions and failing to augment that award from the time of the filing of the Complaint, the Third Circuit relied upon a literal interpretation of the Pennsylvania Business Corporation Law. The panel decided that §1210 of the Pennsylvania Business Corporation Law, 15 Pa.Cons.Stat.Ann. §1210 (Purdon Supp. 1988)(providing that the business and affairs of a corporation shall be managed

by a board of directors) and the case of In Re: Penn Central Securities Litigation, 367 F.Supp. 1158 (E.D.Pa. 1973), while providing a "tenuous" argument, nevertheless provided enough support for the Eddy law firm's prosecution and maintenance of the underlying lawsuit so as to avoid the imposition of sanctions under Rule 11. The Court reasoned that it was plausible for the Eddy law firm to disregard the shareholders' instructions to withdraw as counsel and discontinue the litigation simply because these individuals were acting as shareholders rather than directors. This reasoning completely ignores the fact, uncontested in the record, that the three (3) one-third (1/3) shareholders of Dura Systems Corporation were the same three (3) individuals elected as the only three (3) directors of the Corporation at the May 13, 1987 shareholders' meeting.

Plaintiff's counsel clearly had enough objective information to discontinue their masquerade as counsel for Dura-Systems when two (2) of the three (3) shareholders directed them to discontinue their representation at the May 13, 1987 meeting. Whether the information came from shareholders or directors did not affect the quality of the information or the fact that it was received by Plaintiff's counsel. Notwithstanding the fact that two (2) out of the three (3) shareholders, who were also two (2) of the three (3) directors, instructed them to withdraw as counsel, the Eddy law firm chose to ignore this request and continue to maintain the underlying lawsuit. The irrefutable fact remains that the Eddy law firm and its members had no reason to believe that the same three individuals voting as directors would vote any differently than they had

at the shareholders meeting. The Eddy law firm and its members may not rewrite the factual record to reflect what they think should have occurred. Teamster's Local No. 579 v. B & M Transit, Inc., 882 F.2d 274 (7th Cir. 1989).

The record further demonstrates that subsequent to the May 13, 1987 shareholders' meeting, no directors' meeting was called by Thomas R. Eddy, even though he had been elected as one of the three directors at the shareholders' meeting (214a-216a). If Mr. Eddy sincerely believed that a directors' vote would have changed the instructions given by the shareholders, he could have called such a meeting and put the issue to a vote. This arguably would have been a reasonable inquiry on his part. However, no such directors' meeting was ever called or proposed by Mr. Eddy or members of his law firm because they were well aware that

they would receive the same instructions received at the May 13, 1987 shareholders' meeting. Moreover, even if, as argued below by the Eddy law firm, Mr. Risi had been disqualified as a director and the Corporation became deadlocked, the litigation still would have been terminated because the deadlocked corporation would be subject to dissolution, thereby making the entire lawsuit moot. 15 Pa.Cons.Stat.Ann. §2107A(4)(Repealed 1988).

The belated "directors' argument" was created by the Eddy law firm and its members after the Dura Systems shareholders had already made their intentions known in noticing the shareholders' meeting of May 13, 1987. By giving credence to the Eddy law firm's "director's argument," the Third Circuit has held in effect that a party may forego the reasonable inquiry requirement of Rule

11 provided that their attorneys can later raise a "tenuous" legal argument in support of their actions (Third Circuit op. pg. 17). Thus, the Court of Appeals' decision in this case condones the Eddy law firm's deliberate ignorance of objective facts at material times. By its ruling, the Third Circuit totally ignores Plaintiff's counsel's affirmative duty to conduct reasonable investigation, and instead, shifts the affirmative duty to Defendant by requiring Defendant to in effect prove to Plaintiff's counsel's satisfaction that the litigation is baseless, frivolous and not grounded in fact before Rule 11 sanctions will be imposed.

The shareholders meeting served the purpose of providing the Eddy law firm and its members with objective evidence on the record with which it could determine that maintenance of the lawsuit on behalf

of the Corporation was not supported by a majority of the Corporation's owners. In the alternative, at the very least it triggered a duty of investigation on the part of the Eddy law firm and its members to re-evaluate whether it had authority to proceed on behalf of the corporation from that point forward. Instead, the Eddy law firm and its members prosecuted an appeal on the merits of the underlying case to The Third Circuit for a corporation they were instructed not to represent. As stated in the District Court Opinion, "There cannot be a more basic fact for an attorney to ascertain, prior to placing his signature on a pleading and filing it with the court, than that his client has authorized him to conduct the litigation in question." District Court Opinion, Page 23, (428a).

2. The Eddy law firm and its members failed to investigate whether the majority of the shareholders of a close corporation supported the same litigation before suit was initiated and instead initiated and maintained the lawsuit for an improper purpose even though they were on notice that at least one (1) of the three (3) share holders objected to the Eddy law firm's total control of the corporation before filing suit.

The District Court noted below that the Eddy law firm and its members, "simply lack authority to pursue this lawsuit on behalf of the corporation. [emphasis in original] If this fact was not already crystal clear to Eddy & Osterman, there was certainly no more room for doubt, by any objective standard, after the May 13, 1987 shareholders' meeting." Cohill, J., opinion, p. 23 (428a). In this way, the District Court which imposed sanctions for violations only after May 13, 1987, gave the Eddy law

firm the benefit of the doubt as to its original filing of the complaint on behalf of the corporation and its maintenance of suit. This analysis effectively removed the Eddy law firm's duty to investigate until it was proved by Defendants on the record at the shareholders' meeting on May 13, 1987 that they lacked such authority.

In the current case, Attorney Eddy and his law firm were well aware of the facts because he and his law firm controlled the Plaintiff, Dura Systems, Inc. Thus, there can be no defense to Rule 11 sanctions based upon the Eddy law firm's "reasonable inquiry" as to the facts prior to filing the Dura Systems action. Mr. Eddy and his law firm knew the facts, and intentionally disregarded them in order to file a frivolous lawsuit against Rothbury Investments, Ltd. As will be discussed below, this lawsuit was filed for an improper purpose and was

designed solely to create additional expense and harm to the Defendant and prevent Defendant from creating license relationships with potential licensees in a forty-six (46) state area of the United States. Thus, the Eddy law firm had an ulterior motive to initiate and maintain the lawsuit even after they became notified that it had no basis in fact.

The communication between Angelo Risi and Thomas R. Eddy concerning Mr. Risi's complete exclusion from the corporate affairs of the corporation is relevant background in assessing the motivation of the Eddy law firm in filing and maintaining the underlying lawsuit. See (116a-118a, 17a-19a, 178a-183a) and Opinion of The United States Court of Appeals For The Third Circuit No. 88-3520. This exclusion, inter alia, culminated in the termination of the contract between Rothbury and Dura-Systems. Furthermore,

the Eddy law firm was aware of its exclusion of Mr. Dehus (the third Dura-Systems shareholder) from the affairs of the corporation (35a-38a), giving the Eddy law firm cause to doubt his support of litigation initiated without his knowledge. Therefore, a Rule 11 "reasonable investigation" was mandated by the Eddy law firm before filing the complaint in this action. Plaintiff's counsel's knowledge of the same facts require that the counsel fees of the District Court be augmented in accordance with cross-appeal No. 89-3023.

A review of the entire record, including the related district court case of C.A. 86-1610 and appeals 88-3519 and 88-3546, shows that the current case, C.A. 86-2621, was instituted for an improper purpose in violation of Rule 11. The related case of Dura Corp v. Risi Stone, Ltd., C.A. No. 86-1610, provided further

factual background to the district court as to the likely motives for Mr. Eddy's initiation and maintenance of the Dura System lawsuit. Indeed, the District Court noted in his Opinion that Mr. Eddy confused his investment in Dura-Corp, a corporation which he lawfully controlled, with his standing as a minority shareholder in Dura Systems, which he attempted to control merely as an incorporator/ minority shareholder (419a). Furthermore, the District Court was familiar with the contract issues forming the basis for the Dura Systems lawsuit. These issues brought to the forefront Mr. Eddy's attempt to satisfy Dura System's performance obligations by licensing his own company, Dura-Corp, with additional territory (the State of Florida) without the consent or approval of Rothbury Investments, Ltd., as provided in the contract.

As stated by the Seventh Circuit in Mars Steel Corp. v. Continental Bank N.A., "positions rarely are frivolous in the abstract." 880 F.2d 928 (7th Cir. 1989). In the case at bar, it may not sound "patently unmeritorious or frivolous" (Third Circuit op. pg. 17), for directors to manage a corporation. However, in the context of the actual facts of this case and the Dura-Corp case, it can be seen that Plaintiff's position was not merely frivolous and without merit, it was filed for an improper purpose. The filing and maintenance of the instant lawsuit was occasioned by the benefit which would inure to attorney Eddy's corporation, Dura-Corp. By obstructing the licensing of additional markets in the United States for the Rothbury products, attorney Eddy sought to establish his own company, Dura-Corp, as the only licensee of the Rothbury products

in the country. Furthermore, the improper filing of the Dura Systems case served as a "bargaining chip" that attorney Eddy could dismiss if his demands in the related Dura-Corp litigation, C.A. 86-1610, were met.

During the course of the litigation and before the May 13, 1987 shareholders' meeting, Mr. Eddy and his law firm were provided with ample opportunity and notice to "stop, look and listen." Lieb v. Topstone Industries, Inc., 788 F.2d 151, 157 (3rd Cir. 1986). Upon the filing and service of the Dura Systems Complaint, Defendant Rothbury's counsel sent Attorney Eddy correspondence in February of 1987 warning of Defendant's intention to seek Rule 11 sanctions should Mr. Eddy continue to prosecute the Dura Systems case (Exhibit A, Defendant's Motion for Rule 11 Sanctions in the record, filed May 14, 1987). Mr. Eddy and

his law firm were again provided with notice of the baseless nature of the Dura Systems case when it received Defendant's motion to dismiss for lack of corporate authority supported by the affidavits of Angelo and Antonio Risi as well as Kenneth Dehus.

Despite the above warnings, Attorney Eddy and his law firm continued to operate Dura Systems to the complete exclusion of Mr. Risi and Mr. Dehus. In order for Defendant to build a record in support of it's Motion to Dismiss for lack of corporate authority, Mr. Risi, exercising the rights as a minority shareholder in Dura Systems, was forced to file an action in the Allegheny County Court of Common Pleas to compel the production of the Dura Systems corporate documents under the Pennsylvania Business Corporation Law (180a.). Attorney John D. Eddy appeared in State Court to oppose the production of

said documents and an order of court was entered requiring Dura Systems to produce the documents. These corporate documents are now part of the record and appendix on appeal. (127a.-177a., 181a.) Review of these documents demonstrates, without dispute by Mr. Eddy or his law firm, that Dura Systems was run to the complete exclusion of Messrs. Risi and Dehus. Considerable time and attorney's fees were incurred as a result of the production of corporate documents and calling and holding of a shareholders' meeting (490a., 498a.).

Compounding the corporate authority issue and increasing the legal fees incurred by Rothbury Investments, were the intentional acts of members of the Eddy law firm during this period. After the production of the business records pursuant to court order, the Eddy-installed family board of directors then

purportedly passed an amendment to the Eddy-created by-laws which were never previously approved by the shareholders. The amendment sought to thwart the will of the majority shareholders at the upcoming shareholders' meeting scheduled for May 13, 1987. Specifically, the amendment passed by the Eddy board sought to require unanimous consent of all directors of the corporation to accomplish business at the upcoming shareholders' meeting (173a.-175a.). This deliberate action taken on behalf of the Eddy law firm was expressly conducted in response to the majority shareholders announced intention to direct the corporation to dismiss the instant lawsuit at the May 13, 1987 shareholders' meeting. (173a.-175a.).

In the case before the Court, the critical question of the appeal is whether the Eddy law firm and its members had enough objective information as reflected

in the record before this Court to "stop, look, and listen" before persisting in the prosecution of litigation, or, initiating the litigation in the first place. A review of the related litigation, business interests and motivation of the Eddy law firm and its lawyers convincingly demonstrates that they did, but nevertheless deliberately chose to pursue the litigation of the instant case.

VII. CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

DICKIE, McCAMEY & CHILCOTE, P.C.

By _____
Charles W. Kenrick, Esquire

By _____
Hunter A. McGeary, Jr., Esquire

APPENDIX A

A [illegible]

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

DURA SYSTEMS, INC., a Pennsylvania Business Corporation,	)	
Plaintiff,	)	
v.	)	Civil Action No. 86-2621
ROTHBURY INVESTMENTS, LTD., a Canadian Corporation,	)	
Defendant.	)	

MEMORANDUM OPINION

COHILL, C.J.

I. FACTUAL BACKGROUND

Presently before us is the motion of defendant, Rothbury Investments, Ltd. ("Rothbury"), for sanctions against the law firm of Eddy & Osterman under Rule 11 of the Federal Rules of Civil Procedure. The pertinent factual background of this case was outlined in our prior Memorandum Opinion, filed July 1, 1988, setting forth our rationale for granting summary

judgment on behalf of defendant. We note at the outset, however, that Thomas R. Eddy, Esq., a member of the law firm of Eddy & Osterman, holds one-third of the shares of the plaintiff corporation, Dura Systems, Inc. ("Dura Systems"). Another third of the shares is held by Kenneth Dehus, and the remaining third is jointly held by Angelo and Anthony Risi, who are also shareholders of Rothbury.

Thomas R. Eddy filed the articles of incorporation for Dura Systems on October 22, 1984. On June 10, 1985, he held an "incorporator's meeting" at which he "elected" a board of directors consisting of himself and two of his sons, John D. Eddy, Esq., and Thomas G. Eddy, Esq., who are both also members of the law firm of Eddy & Osterman. This action was initiated by Eddy & Osterman on December 11, 1986. We granted summary judgment on behalf of defendant on July 1, 1988, based

on a finding that there was no genuine issue of material fact precluding the conclusion that "neither the Eddy-appointed board of directors nor the law firm of Eddy & Osterman possesses the requisite authority to maintain this lawsuit." Memorandum Opinion, at 15. We noted an alternative basis for summary judgment, in that "[e]ven if Mr. Eddy and his board possessed the requisite authority to maintain this lawsuit, they would be required to produce evident to establish their underlying claim." Id. However, our review of the comprehensive evidence in the pleading before us led us to conclude that the underlying substantive claim lacked sufficient credibility to withstand a motion for summary judgment. Id. at 15-17.

The present motion for sanctions under Rule 11 was filed on May 14, 1987. On the preceding day, May 13, 1987, the

shareholders of Dura Systems had conducted a shareholders' meeting at the request of Messrs. Risi and Dehus.[1] This was apparently the first shareholders meeting since Thomas R. Eddy appointed himself and his two sons to the board of directors. See Transcript of May 13, 1987 Shareholders' Meeting ("Transcript of May 13"), Exhibit C, Motion to Dismiss Action with Prejudice, at 10; Memorandum Opinion, at 4 (allusion to possible shareholders meeting of April 3, 1985, which was in any case prior to Thomas R. Eddy's appointment of a board of directors).

The May 13 shareholders' meeting had been "duly called by the secretary of

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1 We note that the "Memorandum of Eddy & Osterman in Opposition to Defendant's Motion for Sanctions under Rule 11" alternately refers to the meeting date as May 5, 1987 (at 6), and May 13, 1987 (at 10). The transcript of the meeting, appended as Exhibit C to the defendant's "Motion to Dismiss Action with Prejudice," indicates that the meeting was conducted on May 13, 1987.

(Footnote 1 Continued on Next Page

the corporation [i.e. John D. Eddy]." Transcript of May 13, at 1. At the May 13 meeting, the shareholders voted by proxy to:

(1) elect a new board of directors, composed of Thomas R. Eddy, Kenneth Dehus, and Angelo Risi;

(2) elect new officers;

(3) dismiss the law firm of Eddy & Osterman;

(4) hire Randal E. McCamey, Esq. as counsel to the corporation;

(5) withdraw from this lawsuit; and

(6) direct legal counsel to dissolve the corporation.

It is undisputed that the decisions to dismiss the law firm of Eddy & Osterman, hire Mr. McCamey to represent the corporation, withdraw from this lawsuit, and dissolve the corporation were approved

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(Footnote 1 Continued from Previous Page)
Eddy & Osterman's reply to the motion
(Footnote 1 Continued on Next Page

by a two-thirds vote of the shareholders, and that the remaining one-third shares held by Thomas R. Eddy were voted in opposition to each action. See Transcript of May 13, at 12-13, 14-16, 20-22.

Despite this unequivocal demonstration of the wishes of the majority of the shareholders, Eddy & Osterman persisted in pursuing this lawsuit by filing pleadings with this court, purportedly on behalf of Dura Systems. The defendant has of course been obliged to continue to retain counsel to respond in its defense.

Defendant's motion for Rule 11 sanctions, filed the day after the May 13 shareholders' meeting alleges that:

> (1) neither Dura Systems nor the law firm of Eddy & Osterman has "legal authority to institute and prosecute

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(Footnote 1 Continued from Previous Page)
to dismiss also states that the date was May 13, 1987. We merely note this discrepancy for the record. It does not affect our substantive analysis,
(Footnote 1 Continued on Next Page

> suit in the above matter;" and (2) Eddy & Osterman "knew or should have known that no valid basis existed for instituting a lawsuit, but nevertheless persisted in maintaining the above action without a well-grounded basis in law or fact."

Memorandum Opinion, at 20. We found that the motion merited further consideration, and directed the parties to file responsive memoranda.

Eddy & Osterman filed a "Memorandum of Eddy & Osterman in Opposition to Defendant's Motion for Sanctions under Rule 11" ("Memorandum in Opposition") on July 29, 1988. In its Memorandum in Opposition, Eddy & Osterman protests that our conclusion as to its lack of authority to maintain this lawsuit

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(Footnote 1 Continued from Previous Page) as in either case the meeting occurred prior to May 14, 1987, the date upon which defendant filed the motion presently before us. We will refer to the meeting as the "shareholders meeting of May 13, 1987," since that is the date stated on the cover page of the transcript of the meeting.

is "unfounded and contrary to law." Memorandum in Opposition, at 8. Eddy & Osterman also suggest that a hearing should have been conducted to explore the possible existence of a voting trust. See Memorandum Opinion, at 12-15. We note, however, that Eddy & Osterman have neither alleged that such a voting trust existed, nor indicated that they are in a position to present evidence of its existence.

II. RESPONSE OF EDDY & OSTERMAN

A. Authority of Shareholders to Direct Corporate Affairs

The cornerstone of Eddy & Osterman's argument is that decisions regarding such matters as the retention or dismissal of counsel, and the maintenance of litigation on behalf of the corporation, is within the sole purview of the board of directors. Eddy & Osterman argue that the shareholders were not

empowered to make the decisions they undertook with respect to these matters at the May 13, 1987 meeting.

What concerns us, for the purposes of this motion, is the critical and indisputable fact that the shareholders, whether voting as shareholders (as they did) or as a board of directors (as Eddy & Osterman allege they should have done), decided by a two-thirds vote that this lawsuit, which was nominally brought on behalf of the corporation, should be dismissed. What more could it possibly take to alert a reasonably conscientious attorney that he lacks the most fundamental prerequisite of representation: the authorization of the client? By any objective standard, Eddy & Osterman should have realized as of the May 13 meeting, if not earlier, that the firm lacked authority to pursue this lawsuit.

It is troublesome that Eddy & Osterman continue to insist that the shareholders somehow lack authority to direct the affairs of the corporation insofar as this litigation is concerned. The firm's vigorous advocacy of this dubious legal theory is all the more troubling when juxtaposed with the possibility that self-interest may have clouded the judgment of counsel. Despite its ostensible representation of Dura Systems, Eddy & Osterman is essentially seeking to protect the interests of Thomas R. Eddy, who is a minority shareholder, and possibly also the interests of Mr. Eddy's two sons, who were appointed to the original board of directors by their father, all of whom are members of the law firm of Eddy & Osterman. It was the original board of directors, composed of the three Messrs. Eddy, which appointed

the law firm of Eddy & Osterman to act as counsel in this litigation.

As we noted in our Memorandum Opinion of July 1, 1988:

> Mr. Eddy, as a minority shareholder, may not barricade himself behind the corporate structure he has constructed. A board of directors appointed by a minority shareholder may not indefinitely retain authority to act for the corporation after losing the confidence and support of the majority shareholders. There are other avenues of relief available to disenchanted minority shareholders. See 15 Pa. Cons. Stat. Ann. § 652 [& § 1515].

Memorandum Opinion, at 14.

We state the obvious: shareholders may delegate responsibility to the board of directors, but ultimate authority to direct the affairs of the corporation derives from, and resides with, the shareholders. As we stated in our Memorandum Opinion, and as even Eddy & Osterman admits: "A board of directors may not indefinitely retain authority to act

for the corporation after losing the confidence and support of the majority shareholders." Memorandum Opinion, at 14. It follows that a law firm appointed by a board of directors which was in turn appointed by a minority shareholder who is a member of that law firm, may not indefinitely maintain litigation which is expressly disavowed by the majority shareholders.

Eddy & Osterman insist that the board should have met to decide this issue, because "[t]he shareholders may not usurp the function of the board of directors, unless the corporation is properly registered as a 'close' corporation under Article III of the Pennsylvania Business Corporation Law." Memorandum in Opposition, at 11. As we already noted, the important fact for the purposes of this motion is that the shareholders disavowed this litigation,

which Eddy & Osterman has purportedly maintained on behalf of the corporation. Also, it is indisputable that the board elected by the shareholders at the May 13 meeting would have reached the same conclusion as the shareholders themselves, since the members of the new board and the shareholders, with one exceptions, are identical. The exception is Anthony Risi, who is not a director, but his brother and joint shareholder, Angelo Risi, is.

However, Eddy & Osterman maintain that, had the board met to vote on these matters, Angelo Risi would have been precluded from voting by the "interested director" rule, codified at 15 P.S.C.A. § 1409.1. As is typical of the arguments advanced by Eddy & Osterman in this case, this argument may appear to have some merit at first impression, but is soon dissipates upon critical inspection.

B. <u>The Interested Director Rule</u>

Eddy & Osterman allege that "[a]pparently aware of the pitfalls of a board of directors' vote, the majority shareholders attempted to circumvent the 'interest[ed] director' rule by submitting the issue directly to the shareholders." Memorandum in Opposition, at 12. Eddy & Osterman argue:

> This so-called "interested director" rule has its origins in the time-honored principle that directors, as fiduciaries, cannot act contrary to or compete with the interests of the corporation. Vulcanized Rubber & Plastics Co. v. Scheckter, 400 Pa. 405, 162 A.2d 400 (1960). In the instant case, had the issue of dismissal of the lawsuit been properly placed before the newly-elected board of directors, Messrs. Risi would have been disqualified from voting under the "interested director" rule, due to their ownership interest in Defendant.

Memorandum in Opposition, at 11-12. According to Eddy & Osterman, Mr. Risi would have been disqualified as an "interested director" by virtue of his interest in Rothbury, the defendant

corporation. Presumably, the remaining directors, Messrs. Dehus and Eddy, would not have been disqualified, but would have split on the issue, de facto leaving intact the prior decisions of Mr. Eddy's board. As we stated earlier, the position of Eddy & Osterman may seem logical, until its flaws are revealed upon closer inspection.

As an initial matter, we note that so-called "interested" directors are not peremptorily precluded from participating in decisions affecting their other interests. See 15 P.C.S.A. 1409.1A. The statute provides:

> No contract or transaction between a business corporation and one or more of its directors or officers, or between a business corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for such reason, or solely because the director or officer is present at or participates in the meeting of the board which

authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if:

(1) The material facts as to his interest and as to the contract or transaction are disclosed or are known to the board of directors and the board in good faith authorizes the contract or transaction by a vote sufficient for such purpose without counting the vote of the interested director or directors; or

(2) The material facts as to his interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors or the shareholders.

If we were to accept Eddy & Osterman's analysis, however, we note that Thomas R. Eddy, as a member of the law firm of Eddy & Osterman, could hardly be found "disinterested" on the issue of whether the law firm of Eddy & Osterman should be retained or dismissed as counsel

for Dura Systems. Not only would this self-interest have disqualified him (by his firm's own analysis) from voting on these matters as a member of the board installed at the May 13 meeting, but Mr. Eddy's "interested" status extends back to his tenure on the board of directors which he initially "elected" and which in turn appointed Eddy & Osterman to represent Dura Systems. The same "interest" analysis could be applied to John D. and Thomas G. Eddy, who also served on the board which appointed Eddy & Osterman. Thomas R. Eddy's overlapping interests do not end here.

It is helpful at this point to recall that the affairs of Messrs. Eddy and Risi, and the various entities they control, are extensively intertwined, as follows:

Risi Stone Ltd., Dura-Corp, and the Licensing Agreement:

(1) Angelo and Anthony Risi are the principal shareholders of Risi Stone, Ltd., the Canadian entity which owns certain patents granted to Messrs. Risi;

(2) Mr. Eddy is the controlling shareholder of Dura-Corp, a Pennsylvania corporation formed prior to the formation of Dura Systems;

(3) Dura-Corp is licensed by Risi Stone, Ltd. to produce and market the patented products in Pennsylvania, West Virginia, Ohio, and Maryland. This license, entered into on November 16, 1983, preceded the formation of Dura Systems. See Dura-Corp v. Risi Stone, Ltd., Opinion at 1, Civil Action No. 86-1610, (W.D. Pa. July 1, 1988);

(4) Messrs. Risi and Eddy have an ongoing disagreement concerning the scope of the licensing rights granted to Dura-Corp by Risi Stone Ltd., which we have ordered resolved through arbitration in accordance with the terms of the license agreement, see Dura-Corp v. Risi Stone, Ltd., Civil Action No. 86-1610, (W.D. Pa. July 1, 1988) (Opinion and Order granting motion to compel arbitration).

Rothbury Investments, Ltd., Dura Systems, and the Franchising Agreement:

(1) Angelo and Anthony Risi are the principal shareholders of Rothbury Investments, Ltd., a Canadian corporation which owns the patent

for an invention known as a "Retaining Wall System," and other property rights associated therewith;

(2) On January 29, 1984, Rothbury and Messrs. Risi, Eddy, and Dehus all entered into a "Franchising Agreement" which provided that a corporation or other entity would be formed to act as Rothbury's exclusive agent to grant rights to manufacture and sell all Risi Products in various parts of the United States, with approval from Rothbury, which approval could not be unreasonably withheld;

(3) The Franchise Agreement provided that Rothbury was empowered to terminate the Franchise Agreement if the franchisor entity failed to satisfy certain performance standards, the first of which required enfranchisement of territories comprising at least 15% of total United States population within two years;

(4) Dura Systems is the franchisor entity formed as contemplated by the Franchising Agreement;

(5) As previously stated, the shareholders of Dura Systems are Thomas R. Eddy (1/3), Angelo and Anthony Risi (jointly 1/3) and Kenneth Dehus (1/3);

(6) It is undisputed that Dura Systems did not submit any franchises for Rothbury's approval during the first two years of Dura Systems' existence, that the

performance deadline was extended from January 29, 1986 until March 31, 1986, but that no new franchises were submitted for Rothbury's approval as of March 31, 1986.

It appears to us that Thomas R. Eddy, who was a member of the original board of directors as well as the board installed at the May 13 shareholders meeting, has a rather substantial personal interest in the issue before the shareholders at the May 13 meeting. As noted in the above summary, Mr. Eddy is the controlling shareholder of Dura-Corp, which holds the rights to manufacture and distribute certain inventions patented by Messrs. Risi in Pennsylvania, Ohio, West Virginia, and Maryland. As was also noted in the above summary,the scope of the licensing agreement between Dura-Corp and Risi Stone, Ltd. was the subject of a separate lawsuit which was docketed in this court at civil Action No. 86-1610.

The amended complaint filed by Eddy & Osterman in this action sought a declaratory judgment to the effect that the Franchising Agreement which permits Dura Systems to act as agent in granting licenses, to entities such as Dura-Corp continues in effect because of a waiver of the performance condition or equitable estoppel. In effect, this lawsuit seeks to preserve Dura Systems' (and the Eddys') role in selecting franchisees.

Apparently, the only new franchise contemplated by Dura Systems under Mr. Eddy's management was a franchise to Dura-Corp (which Mr. Eddy controls) for the state of Florida. In fact, as we noted above, a central thesis of the amended complaint is that the Florida franchise to Dura-Corp would have satisfied the performance condition, had it been approved by Rothbury. However, Mr. Eddy never submitted the Florida franchise

to Rothbury for approval. Memorandum in Opposition, at 5-6; see infra at 20-22.

At this juncture, it becomes very difficult to discern who is more "interested" than whom. Rothbury, disappointed with Dura Systems' failure to satisfy the performance standards, decided to terminate the Franchise Agreement so that Rothbury would be free to license others. Presumably Rothbury will be reluctant to grant further franchises to Dura-Corp and/or other entities under Eddy control. Eddy & Osterman sought to avert this turn of events by initiating this lawsuit, purportedly on behalf of Dura Systems, and seeking a declaratory judgment which would propagate the status quo, effectively limiting Rothbury's choice of franchisees to those proposed by Dura Systems.

Mr. Eddy now claims to have invested $1.5 million in the construction

of manufacturing facilities for use by Dura-Corp. Memorandum in Opposition, at 3. Although this fact may be relevant in some other context (such as the dispute between Dura-Corp and Risi Stone, Ltd.), Mr. Eddy's investment in Dura-Corp is not relevant to the question of whether Eddy & Osterman have authority to act on behalf of Dura Systems. We venture that an attorney more disinterested than Eddy & Osterman might have provided more sensible advice to Mr. Eddy. Eddy & Osterman may have confused the interests of their purported client (Dura Systems) with those of Mr. Eddy, as attested by this excerpt from the May 13 shareholders' meeting:

> Mr. Eddy and the other members of the Board of Directors feel that it was both necessary and appropriate to do everything properly in their power to defend the corporation against Messrs. Risi and Mr. Dehus, who are merely seeking to advance their own interests at the expense of the corporation.

Transcript of May 13 Meeting, at 9. Mr. Eddy views himself as the embattled "defender" of Dura Systems. A thankless task indeed, since he is defending Dura Systems (and his own interests) from its majority shareholders.

If Mr. Eddy has grievances against the majority shareholders, there are available avenues of relief. See infra at 15-18 and 24. But this lawsuit, as Eddy & Osterman has framed it, is not a proper vehicle for redress. Mr. Eddy errs when he confuses his interests with those of the Dura Systems corporation. He is not one and the same with the corporation, and his grievances are not the corporation's. This is not a cause of action properly attributable to the corporation. See generally Moffatt Enterprises, Inc. v. Borden, Inc., 807 F.2d 1169, 1176-77 (3d Cir. 1986).

In sum, if Messrs. Risi are "interested directors," then Thomas R. Eddy is, and was, no less. Eddy & Osterman can hardly complain of "self-interest" on the part of the Risis, even as the firm disingenuously asks for equitable relief, nominally on behalf of Dura Systems, but more realistically on behalf of the members of their own firm.

C. Fiduciary Duty to Minority

In its Memorandum in Opposition, Eddy & Osterman finally acknowledge that:

> Ultimately, however, it is not important for purposes of deciding the instant case whether the issue of the dismissal of this lawsuit was properly placed before the shareholders or the directors. In either case, the Risis and Dehus could not legally prevail. Having formed a majority coalition, they assumed a fiduciary obligation to the corporation and to Eddy, the minority shareholder.

Memorandum in Opposition, at 12. It is true enough that the Pennsylvania Supreme Court has pronounced a "quasi-fiduciary"

duty on the part of majority shareholders toward the minority. Hornsby v. Lohmeyer, 364 Pa. 271, 275, 72 A.2d 294, 298 (1950). For example, majority shareholders may not exclude minority shareholders from their "proper share of benefits accruing from the enterprise." Id. Equitable remedies are available to minority shareholders for abuse of power by the majority. See, e.g., Ferber v. American Lamp Corp., 469 A.2d 1046 (Pa. 1983); Weisbecker v.Hosiery Patents, 356 Pa. 244, 51 A.2d 811 (1947).

However, Eddy & Osterman combine this "quasi-fiduciary" duty with their "interested director" thesis to propose a formula that would prevent the majority shareholders from ever taking any action which works against he interests of Mr. Eddy:

> The inexorable conclusion which results from a literal reading of this statutory rule is that a proposed corporate business transaction which is characterized by bad faith and self-dealing on the

> part of the majority directors or shareholders is "void" and therefore legally ineffectual.
> ...
> In the instant case, Eddy, the minority shareholder, attempted to rebuff the dismissal of this lawsuit and dissolution of the corporation by the majority shareholders. It is inconceivable that these proposed transactions were intrinsically fair to the corporation or motivated by the good faith intentions of the majority. On the contrary, Plaintiff has contended that the majority, which was dominated by the Risis, was motivates strictly by its desire to promote the interests of Rothbury; and that their purported actions were undertaken without regard to the best interests of Dura Systems, were devoid of fairness and good faith, and were in breach of the majority's fiduciary duty to the minority shareholder.

Memorandum in Opposition, at 13-14. Thus Eddy & Osterman propose that Messrs. Risi and Dehus are forever forestalled from any action against the interests of Mr. Eddy.

This proposal fails to explain why Messrs. Eddy, when they composed the board of directors, were not similarly constrained from initiating hostile action (such as this lawsuit) against the Risi

interests. Once again, Mr. Eddy has cast himself as the sole arbiter of "the best interests of Dura Systems."

We are compelled to point out that it is not patently in "bad faith" or "unfair to the corporation" for the majority shareholders to vote to dismiss a lawsuit filed at the behest of the minority shareholder against an entity controlled by one of the majority shareholders, and to dissolve the corporation. In order to obtain the equitable relief he seeks, Mr. Eddy would have to establish that the decisions of the majority shareholders are fraudulent, fundamentally unfair, or without a business reason. See Dower v. Mosser Industries, Inc., 648 F.2d 183, 189-90 (3d Cir. 1981). As the Third Circuit Court of Appeals has noted in the context of a minority shareholders' challenge to a proposed merger:

> The heart of plaintiffs' state law argument is that the elimination of the minority through a merger is inherently unfair. But the fiduciary duty owed by the majority to the minority does not prevent a cash out under Pennsylvania law. There must be fraud or fundamental unfairness before such a merger may be enjoined by the courts.

Id. In sum, the minority may not indefinitely thwart the will of the majority, in the absence of "fraud or fundamental unfairness." Eddy & Osterman simply have not produced evidence of such fraud or fundamental unfairness as to justify the relief Eddy & Osterman seeks. We find no genuine issue of material fact as to this point.

D. Underlying Substantive Claims

In its Memorandum in Opposition, Eddy & Osterman continue to argue the merits of the underlying substantive claims. We note once again that we granted summary judgment on the grounds that Eddy & Osterman lacked authority to

pursue this lawsuit. We alternatively held that there was no genuine issue of material fact as to the underlying substantive claims.

1. Waiver

Eddy & Osterman have argued that the performance condition contained in the Franchise Agreement had been waived or modified to extend beyond March 31, 1986. In our Memorandum Opinion, we held that:

> "Since the alleged modification or waiver was not reduced to writing, it would have to be proved with 'such specificity and directness as to leave no doubt of the intention of the parties to change what they had previously solemnized by a formal document.' Gloeckner v. School District of Town of Baldwin, 405 Pa. 197, 175 A.2d 73, 75 (1961)." "In Pennsylvania, the rule is clear that an 'oral contract which modifies or changes or cancels a prior written contract must be proved by evidence which is clear precise and convincing.'" Trident Corp. v. Reliance Insurance Co., 350 Pa. Super. 142, 504 A.2d 285, 287-88 (1986). Based on the record before us, it would not be possible for Mr. Eddy to prove by clear precise and convincing evidence that the performance deadline was extended by mutual agreement beyond March 31,

> 1986. Thus, there appears to be no genuine issue of material fact with respect to the substantive claim.

Memorandum Opinion, at 16-17. We will briefly review the facts surrounding the waiver argument.

First, there is no dispute as to the fact that the original performance deadline of January 29, 1986, was extended until March 31, 1986. There is no dispute that the performance condition remained unsatisfied as of March 31, 1986. During the month of April, 1986, Angelo Risi and Thomas R. Eddy corresponded as summarized in our Memorandum Opinion:

> Mr. Eddy maintains that Mr. Risi's letter of April 1, 1986, Defendant's Reply Brief, Exhibit A, reduced the new performance standards to writing. However, we find that this letter contains a mere proposal which contemplates further negotiation. Furthermore, Mr. Eddy's April 14, 1986 letter to Mr. Risi serves to confirm that the parties had not reached agreement. Defendant's Reply Brief, Exhibit B. Finally Mr. Risi's letter of April 23, 1986, appears to unequivocally terminate any negotiations to modify

> or extend the Franchise Agreement. Complaint, Exhibit D.

Eddy & Osterman argue that:

> "where time for performance of a contract is extended from time to time, with no intention manifested to hold to literal performance, a party cannot rescind without a demand for strict compliance within a reasonable time." Dempsey v. Stauffer, 182 F.Supp. 806 (E.D. Pa. 1960)....
> ....
> The facts of the instant case fit squarely within the above-stated principles of law. The Risis first extended the January 29 deadline, and then induced Mr. Eddy to ignore the March 31 deadline by continuing to negotiate the terms of a revised Franchising Agreement. Whether such negotiations, in fact, ripened into a legally enforceable oral agreement is not controlling, because the Risis could not lawfully declare a termination of the Franchising Agreement without first demanding strict performance of the original performance standards within a reasonable time.

Memorandum in Opposition, at 16-17. We find these arguments meritless. The argument that "continuing negotiations" could have "induced Mr. Eddy to ignore the March 31 deadline" and thereby constituted

a waiver is simply not credible enough to create a genuine issue of material fact.

Eddy & Osterman fault Rothbury for failing to demand strict performance by the March 31 deadline. However, the record clearly indicates that the Risis were dissatisfied with the current state of affairs, and communicated this to Eddy. See Letter of April 1, 1986, Defendant's Reply Brief, Exhibit A. Letter of April 23, 1986, Complaint, Exhibit D. The single extension that had been granted in the past was very limited in scope (from January 29 to March 31), and the Risis were clearly interested in obtaining performance. We find it incredible that these actions could be interpreted as a waiver.

2. Equitable Estoppel

Eddy & Osterman state:

> It must be remembered that by written agreement dated January 23, 1986 (Amended complaint, Ex. "B"), Dura Systems had granted a franchise

> to Dura-Corp for the State of Florida which, if subsequently approved by Rothbury, would have enabled Dura Systems to meet the original performance standard.... Dura Systems did not, however, seek Rothbury's formal approval of the Florida franchise because of the ongoing negotiations with Rothbury.

Memorandum in Opposition, at 18. Once again, it is not obvious why "ongoing negotiations" would have prevented Dura Systems from submitting the Florida franchise for Rothbury's approval, which approval according to the terms of the Franchise Agreement could not be unreasonably withheld. This written agreement for the Florida franchise pre-dated not only the March 31 deadline, but even the January 29 deadline. By convoluted logic, Eddy & Osterman blame Rothbury for this failure to submit the Florida franchise to Rothbury:

> Defendant, by continuing to negotiation with Plaintiff after the expiration of the March 31 deadline, tacitly assumed the position that such deadline would not be enforced. Plaintiff in turn relied on the

> continuing good faith negotiations between the parties and consequently ceased its pursuit of the enfranchisement of the State of Florida.

For whatever reason why the Florida franchise was not submitted for Rothbury's approval, it would offend equitable principles to permit Mr. Eddy to rely on this omission to estop Rothbury from terminating the Franchising Agreement.

Equitable estoppel, as Eddy & Osterman point out, may occur:

> where one by his words or conduct willfully causes another to believe in the existence of a certain state of things, and induces him to act on that belief, so as to latter his own previous position, the former is [pre]cluded from averring against the alter a differen[t] state of things as existed at the same time.

Ervin v. City of Pittsburgh, 339 Pa. 241, 14 A.2d 297 (1940). As we noted in Kann v. Keystone Resources, Inc., 575 F.Supp. 1084, 1093 (W.D. Pa. 1983):

> Before applying the doctrine of equitable estoppel, we must analyze the interplay of conduct between the parties.

> As to the party being estopped, it must be shown that: 1) by acts, representations or silence, one party induced another to believe certain facts; 2) the representing party expected the other party to act upon such representations; 3) the party making the representations possessed actual or constructive knowledge of the true facts. GAF Corporation v. Amchem Products, Inc., 399 F.Supp. 647, 657 (E.D. Pa. 1975), rev'd on other grounds 570 F.2d 457 (3d Cir. 1978), and cases cited therein.
>
> As to the party seeking the estoppel, the law requires: 1) lack of knowledge of the truth; 2) reliance upon the representation of the other party; 3) action based upon that representation which changed his position prejudicially. Id.

The reliance of the party seeking the estoppel must be in good faith. Goodwin v. Hartford Life Ins. Co., 491 F.2d 332 (3d Cir. 1974). In any event, Eddy & Osterman has not alleged any "change in position" on the part of Messrs. Eddy after the extended deadline of March 31, 1986, or even after January 23, 1986 (as of when they could have submitted the Florida franchise to Rothbury and still

satisfied the original deadline). Foregoing the submission of the Florida franchise is simply not, as a matter of law, the sort of "change of position" which equitable estoppel is intended to remedy.

III. IMPOSITION OF SANCTIONS UNDER RULE 11

Rule 11 provides:

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

"The standard for testing conduct under Rule 11 is reasonableness under the circumstances." Teamsters Local Union No. 430 v. Cement Express, Inc., ___ F.2d ___, ___ (3d Cir. 1988) (citing Gaiardo v. Ethyl Corp., 835 F.2d 479, 485 (3d Cir.

1987)). "Rule 11 is intended only for exceptional circumstances." Id.

There cannot be more basic fact for an attorney to ascertain, prior to placing his signature on a pleading and filing it with the court, than that his client has authorized him to conduct the litigation in question. By signing and filing the pleading, the attorney implicitly attests that he is authorized by his purported client to conduct the litigation.

It is obvious that Thomas R. Eddy's interests have diverged from those of the majority shareholders and, consequently, from those of the corporation. It is equally obvious that Eddy & Osterman simply lack authority to pursue this lawsuit on behalf of the corporation. If this fact was not already crystal clear to Eddy & Osterman, there was certainly no more room for doubt, by

an objective standard, after the May 13, 1987 shareholders' meeting. Furthermore, Eddy & Osterman have not made any attempt to recast this lawsuit in a more appropriate form.

We pause to note that the course of action undertaken by Eddy & Osterman in this lawsuit is not only exasperating, but also puzzling, in light of the fact that aggrieved minority shareholders do have available avenues of relief. As a minority shareholder, Mr. Eddy may well be entitled to some sort of compensation for any investment he may have made in Dura Systems, but his lawsuit, in the format initiated and maintained by Eddy & Osterman, is hardly the appropriate vehicle to address his claims. We note, however, that Eddy & Osterman has not made specific allegations as to any investment by Mr. Eddy in Dura Systems. Nor is this lawsuit an appropriate vehicle for any

redress owing to Mr. Eddy as a result of his investment in manufacturing facilities on behalf Dura-Corp. Unfortunately, this lawsuit as it has been initiated and maintained by Eddy & Osterman is not only unauthorized, but also apparently unfounded in law and fact.

More to the point, we find that Eddy & Osterman have abused the litigative process to such a degree that the imposition of sanctions is warranted. Consequently, we will impose sanctions for attorneys' fees and expenses incurred by Rothbury in its defense after May 13, 1987. We will direct defendant to submit a duly attested account of its attorneys' fees and expenses, incurred since May 13, 1987 in defense of this lawsuit.

Finally, we turn to one other aspect of Eddy & Osterman's conduct of this case which we find particularly abusive. On May 28, 1987, Eddy & Osterman

filed a reply to plaintiff's motion to dismiss this action with prejudice, in which Eddy & Osterman infer that the attorney appointed by the shareholders at the May 13, 1987 meeting, Randal E. McCamey, Esq., is associated with the law firm of Dickie, McCamey & Chilcote, P.C. Eddy & Osterman then allege that Dickie, McCamey & Chilcote and Randal E. McCamey are "attempting to represent both parties to this lawsuit, thereby engaging in a serious conflict of interest which would prevent the fair, unbiased and objective representation of the Plaintiff in this matter." This allegation, attested by the signatures of John D. Eddy, Esq. and Thomas G. Eddy, Esq., is completely unfounded. As we noted in our Memorandum Opinion, at 5, Mr. McCamey is not in any way associated with the law firm of Dickie, McCamey & Chilcote. Any cursory inquiry on the part of Eddy & Osterman

would have revealed this fact. As defendant has not filed responsive pleadings, we will withhold imposition of sanctions on this aspect of the case.

s/Maurice B. Cohill, Jr.
Maurice B. Cohill, Jr.
Chief Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

DURA SYSTEMS, INC., a Pennsylvania Business Corporation,	)	
Plaintiff,	)	
v.	)	Civil Action No. 86-2621
ROTHBURY INVESTMENTS, LTD., a Canadian Corporation,	)	
Defendant.	)	

ORDER

AND NOW, to-wit, this 11th day of October, 1988, it is hereby ORDERED, ADJUDGED, and DECREED that defendant's motion for sanctions against the law firm of Eddy & Osterman under Rule 11 of the Federal Rules of Civil Procedure be and hereby is GRANTED in that defendant be and hereby is ORDERED to reimburse defendant for attorneys' fees and expenses incurred in defense of this law suit after May 13, 1987, upon defendant's submission of a

duly attested accounting of attorneys' fees and expenses, and upon our approval of said accounting of attorneys' fees and expenses.

IT IS FURTHER ORDERED that Defendant shall file said duly attested accounting of attorneys' fees and expenses no later than November 1, 1988.

s/Maurice B. Cohill, Jr.
CHIEF JUDGE

APPENDIX B

A 0145

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

DURA SYSTEMS, INC., a Pennsylvania Business Corporation,	)	
Plaintiff,	)	
v.	)	Civil Action No. 86-2621
ROTHBURY INVESTMENTS, LTD., a Canadian Corporation,	)	
Defendant.	)	

MEMORANDUM ORDER

On October 11, 1988, we granted defendant's Motion for Sanctions awarding defendant counsel fees and expenses incurred after May 13, 1987, in defense of this action. On December 21, 1988, we held a hearing on the determination of said counsel fees and expenses. After consideration of the evidence presented by defendant at the hearing we are satisfied

that defendant has incurred $12,275.00 in counsel fees and expenses.

We have reviewed in camera the redacted portions of the legal bills submitted as exhibits by counsel for the defendant and find that they do, indeed, represent matters subject tot he attorney-client privilege as asserted by defendant's counsel at the hearing on this matter.

Also at the hearing we agreed to withhold issuing this Order until we received the Order of the United States Court of Appeals for the Third Circuit on the appeal taken by plaintiff. Today we received the Third Circuit Opinion and see no reason to delay this matter further.

AND NOW, to wit, this 22nd day of December, 1988, it is ORDERED, ADJUDGED and DECREED that plaintiff be and hereby is DIRECTED to pay defendant the sum of

$12,275.00 on or before Friday, January 6, 1989.

s/Maurice B. Cohill, Jr.
Maurice B. Cohill, Jr.
Chief Judge

cc: All counsel of record

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

DURA SYSTEMS, INC., a Pennsylvania Business Corporation,	)	
Plaintiff,	)	
v.	)	Civil Action No. 86-2621
ROTHBURY INVESTMENTS, LTD., a Canadian Corporation,	)	
Defendant.	)	

ORDER OF COURT

AND NOW to wit this 3rd day of January, 1989, it is hereby Ordered, Adjudged and Decreed that this Court's Memorandum Order of December 22, 1988 is amended to read as follows:

AND NOW to wit this 3rd day of January, 1989, it is hereby Ordered, Adjudged and Decreed that Plaintiff, the law firm of Eddy & Osterman, and attorneys Thomas R. Eddy, John D. Eddy and Thomas G.

Eddy are directed to pay Defendant the sum of $12,275.00 on or before Friday, January 6, 1989.

s/Maurice B. Cohill, Jr.
United States District Judge

APPENDIX C

A 1150

Filed: September 19, 1989

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 89-3005 and 89-3023

DURA SYSTEMS, INC.,
A Pennsylvania Business Corporation

Appellant in 89-3005

v.

ROTHBURY INVESTMENTS, LTD.,
A Canadian Corporation

Appellant in 89-3023

On Appeal from the United States District
Court for the Western District
of Pennsylvania
(D.C. Civil Action No. 86-2621)

Argued July 17, 1989

Before: STAPLETON, SCIRICA and ROSENN,
Circuit Judges

(Filed September 19, 1989)

JOHN D. EDDY, ESQ. (Argued)
Eddy & Osterman
2600 Grant Building
Pittsburgh, Pennsylvania 15219

Attorney for Appellant-
Cross-Appellee, Dura Systems, Inc.

HUNTER A. McGEARY, JR., ESQ. (Argued)
CHARLES W. KENRICK, ESQ.
Dickie, McCamey & Chilcote, P.C.
Two PPG Place, Suite 400
Pittsburgh, Pennsylvania 15222

Attorneys for Appellee-
Cross-Appellant,
Rothbury Investments, Ltd.

OPINION OF THE COURT

SCIRICA, *Circuit Judge*.

Plaintiff Dura Systems, Inc., the law firm of Eddy & Osterman and its members Thomas R. Eddy, John D. Eddy and Thomas G. Eddy, individually, appeal the district court's imposition of Rule 11 sanctions. We will reverse the order of the district court.

I.

This is an appeal from an order of the United States district court awarding $12,275.00 in attorneys fees and expenses to the defendant Rothbury Investments, Ltd. under Rule 11 of the Federal Rules of Civil Procedure.

The underlying lawsuit from which these Rule 11 proceedings developed arose from a written franchising agreement between Dura Systems and Rothbury Investments dated January 29, 1984. The franchising agreement granted Dura Systems the right to act as exclusive agent for Rothbury to sell franchises in the United States for the manufacture and distribution of certain patented concrete products developed by Rothbury, and established performance standards to be met by Dura Systems. On April 23,

1986. Rothbury attempted to terminate the franchising agreement on the grounds that Dura Systems had failed to meet the performance standards. In response, Dura Systems sued for a declaratory judgment establishing its right to act as exclusive franchising agent and to enjoin Rothbury from granting to any third party the right to manufacture, distribute, or sell the products. The district court granted summary judgment for Rothbury and this court affirmed. *Dura Systems, Inc. v. Rothbury Investments Ltd.*, No. 88-3520, mem. op. (3d Cir. December 19, 1988).

Rothbury Investments, Ltd. is a Canadian corporation which owns certain United States patents and trademarks on a concrete retaining wall system invented by Angelo and Anthony Risi, Canadian citizens. These patents and trademarks were originally applied for and transferred to Rothbury by another Canadian corporation, Risi Stone, Ltd. Both Rothbury and Risi Stone are owned and managed by the Risis. Seeking to market and distribute the Risi retaining wall system in the United States, Rothbury entered into the franchising agreement described above with Thomas R. Eddy, an attorney, Kenneth Dehus, a former client of the Eddy's law firm, Eddy & Osterman, and the Risis. Pursuant to the franchising agreement, the individuals agreed to form another corporation (Dura Systems) to act as Rothbury's exclusive agent for franchising the right to manufacture and sell Risi products in the United States.

Dura Systems was thereafter incorporated on October 22, 1984 in Pennsylvania by Thomas R. Eddy. The shares of Dura Systems were to be owned one-third by the Risis, one-third by Dehus, and one-third by Thomas R. Eddy. On June 10, 1985, Thomas R. Eddy, as permitted by Pennsylvania

business corporation law "elected" a board of directors for Dura Systems, which included himself and his two sons, John D. Eddy, and Thomas G. Eddy, all members of the law firm of Eddy & Osterman. The board then met and elected officers: Thomas R. Eddy, President; Kenneth Dehus, Vice-President; Angelo Risi, Vice-President; and John D. Eddy, Secretary.

In the meantime, differences arose between the franchisee and Rothbury Investments concerning the performance of the terms of the franchising agreement, ultimately resulting in the litigation referred to above. As a consequence, on May 13, 1987, the shareholders of Dura Systems met at the request of the Risis and Dehus. At the meeting, the shareholders voted, in this sequence, to (1) amend the by-laws; (2) dismiss the law firm of Eddy & Osterman as legal counsel to the corporation and hire Randal E. McCamey, Esq. as counsel to the corporation; (3) withdraw the lawsuit against Rothbury concerning the franchising agreement; (4) elect a new Board of Directors; (5) elect new officers; and (6) dissolve the corporation. As a result, McCamey filed his appearance as counsel for Dura Systems and moved to dismiss the lawsuit against Rothbury with prejudice. Thomas R. Eddy, as minority shareholder, objected to the May 13 shareholder resolutions on the grounds that they were ultra vires and unlawful. Despite the May 13 resolutions, Eddy & Osterman continued to prosecute the law suit against Rothbury by filing pleadings in the name of the corporation. Consequently, Rothbury has been obliged to retain and compensate counsel to defend the suit.

Rothbury filed its motion for Rule 11 sanctions the day after the May 13 shareholders' meeting, alleging that:

> (1) neither Dura Systems nor the law firm of Eddy & Osterman has "legal authority to institute and prosecute suit in the above matter;" and (2) Eddy & Osterman "knew or should have known that no valid basis existed for instituting a lawsuit, but nevertheless persisted in maintaining the above action without a well-grounded basis in law or fact."

After considering both parties memoranda, the district court granted Rothbury's motion for Rule 11 sanctions on October 11, 1988, pending Rothbury's submission of an accounting of attorney's fees and expenses. On January 3, 1989, the court amended its earlier order to include Plaintiff Dura Systems, the law firm of Eddy & Osterman, and attorneys Thomas R. Eddy, John D. Eddy, and Thomas G. Eddy as the parties subject to the order, and granted Rothbury $12,250.00 in attorney's fees and expenses. Dura Systems appeals the award of counsel fees and expenses under Rule 11. Rothbury cross-appeals, seeking an increase in the amount of the awarded attorney's fees and expenses to $30,325.00.

II.

Before we can address the merits of the district court's decision to grant Rule 11 sanctions in this case, we must first determine whether Eddy & Osterman, and the Eddy brothers individually, may be considered parties to this appeal because they were not specifically named in the notice of appeal. The content of a notice of appeal is prescribed by Fed. R. App. P. 3(c) of the Federal Rules of Appellate Procedure:

> (c) Content of the Notice of Appeal
> The notice of appeal shall specify the party or parties taking the appeal; shall designate the

> judgment, order or part thereof appealed from; and shall name the court to which the appeal is taken. . . . An appeal shall not be dismissed for informality of form or title of the notice of appeal.

Fed. R. App. P 3(c). Compliance with Fed. R. App. P. 3(c) is a jurisdictional prerequisite. Failure to file a notice of appeal in accordance with the specificity requirement of Fed. R. App. P. 3(c) presents a jurisdictional bar to the appeal. *Torres v. Oakland Scavenger Co.*, 108 S. Ct. 2405, 2409 (1988); *Kowaleski v. Dep't of Labor*, No. 88-3657, slip op. at 6 (3d Cir. July 17, 1989).

Dura Systems was the only party named in the notice of appeal from the district court's order imposing Rule 11 sanctions, an order which specifically named Dura Systems, the law firm of Eddy & Osterman, and the Eddys individually, as the parties subject to the order to pay attorney's fees and expenses. Appellees contend that this discrepancy violates the requirements of Fed. R. App. P. 3(c).

The Eddys and the law firm make several arguments in response.[1] First, they contend that the requirements of Fed. R. App. P. 3(c) may be deemed satisfied by a Consent Order of January 31, 1989, entered by this court granting stay of the district court judgment pending appeal, in which the judgment was secured by the accounts receivable of

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1. On July 11, 1989, Dura Systems, Eddy & Osterman, and the Eddys moved this court for leave to amend the Notice of Appeal to name the omitted parties. We will deny the motion under Fed.R.App.P. 26(b), which explicitly prohibits the court from enlarging the time for filing a notice of appeal. *See Carter v. Rafferty*, 826 F.2d 1299, 1304 (3d Cir. 1987)(quoting *West v. Keve*, 721 F.2d 91, 95 (3d Cir. 1983))("Where the litigant fails to file a timely notice of appeal within the prescribed period, the litigant loses the right to an appeal on the merits of the predicate controversy."); *cert. denied*, 108 S. Ct. 711 (1988).

the law firm of Eddy & Osterman. The Consent Order specifically names, in addition to Dura Systems, the law firm of Eddy & Osterman and Thomas R. Eddy, John D. Eddy and Thomas G. Eddy, individually, as parties against whom Rothbury may confess judgment in the event that this court affirms the award of attorney's fees, and was entered within the period required for timely notice of appeal under Fed. R. App. P. 4(a)(1). Second, they claim that they could reasonably have read Fed. R. App. P. 3(c) to have required only that the named "party or parties" to the underlying action be included in the notice of appeal. This interpretation would have led them to conclude that only Dura Systems was properly named in the notice of appeal, since neither Eddy & Osterman nor the Eddys individually were originally named "parties" to the underlying action.

The sufficiency requirements of a notice of appeal under Fed. R. App. P. 3(c) were recently addressed by the United States Supreme Court in *Torres v. Oakland Scavenger Co.*, 108 S. Ct. 2405 (1988), in which the petitioner, as one of sixteen plaintiffs seeking to appeal the district court's dismissal of the complaint, was not named in the notice of appeal because of a clerical error. The Court granted certiorari "to resolve a conflict in the Circuits over whether a failure to file a notice of appeal in accordance with the specificity requirement of Fed. R. App. P. 3(c) presents a jurisdictional bar to the appeal."[2]

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2. 108 S. Ct. at 2407 & n.1 (comparing *Farley Transportation Co. v. Santa Fe Trail Transportation Co.*, 778 F.2d 1365, 1368-70 (9th Cir. 1985)(failure to specify party to appeal is jurisdictional bar); *Covington v. Allsbrook*, 636 F.2d 63, 64 (4th Cir. 1980)(same); *Life Time Doors, Inc. v. Walled Lake Door Co.*, 505 F.2d 1165, 1168 (6th Cir. 1974)(same) with *Ayres v. Sears, Roebuck & Co.*, 789 F.2d 1173, 1177 (5th Cir. 1986)(appeal by

In formulating its holding, the Court made clear that Rules 3 and 4 of the Federal Rules of Appellate Procedure create a jurisdictional threshold, and that the requirements of the two rules may not be abrogated for "good cause shown" under Fed. R. App. P. 2.[3] *Id.* at 2409. Moreover, the fact that Rule 3 excuses "informality of form or title" in a notice of appeal does not forgive compliance with the Rule's requirements: "[p]ermitting imperfect but substantial compliance with a technical requirement is not the same as waiving the requirement altogether as a jurisdictional threshold." *Id.* at 2408; *see also Kowaleski*, slip op. at 7 (citing *Allen Archery, Inc. v. Precision Shooting Equip., Inc.*, 857 F.2d 1176, 1177 (7th Cir. 1988))(court must insist on "punctilious, literal, and exact compliance with the requirement in Fed. R. App. P. 3(c) that the notice of appeal 'shall specify the party or parties taking the appeal'"). Although the *Torres* Court mandated compliance with the specificity requirement of Fed. R. App. P. 3(c), it recognized that

> the requirements of the rules of procedure should be liberally construed and that 'mere technicalities' should not stand in the way of consideration of a case on its merits. Thus, if a litigant files papers in a fashion that is technically at variance with the letter of a procedural rule, a

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party not named in notice of appeal is permitted in limited circumstances); *Harrison v. United States*, 715 F.2d 1311, 1312-13 (8th Cir. 1983)(same); *Williams v. Frey*, 551 F.2d 932, 934 n.1 (3rd Cir. 1977)(same)).

3. Under Fed. R. App. P. 2, for good cause shown, "a court of appeals may, except as otherwise provided in Rule 26(b), suspend the requirements or provisions of any of these rules in a particular case on application of a party or on its own motion and may order proceedings in accordance with its direction."

> court may nonetheless find that the litigant has complied with the rule if the litigant's action is the functional equivalent of what the rule requires.

Id. at 2408-09 (citing *Houston v. Lack*, 108 S. Ct. 2379 (1988)). This approach mirrors the practice sanctioned in the Advisory Committee Notes to the 1979 amendment to Fed. R. App. P. 3(c), which cites with approval cases holding that, "so long as the function of notice is met by the filing of a paper indicating an intention to appeal, the substance of the rule has been complied with." Fed. R. App. P. 3(c) advisory committee's note (citing *Cobb v. Lewis*, 488 F.2d 41 (5th Cir. 1974); *Holley v. Capps*, 468 F.2d 1366 (5th Cir. 1972)).

In this case, we hold that the Consent Order serves as the "functional equivalent" of what the rule requires. The Consent Order was filed within the time for filing an appeal under Fed. R. App. P. 4, and, by naming the law firm and the Eddys as the parties securing the district court judgment pending appeal, served to notify the court and the opposing parties of their intention to appeal. Given these factors, the Consent Order satisfies the underlying purpose of the rule of "provid[ing] notice both to the opposition and to the court of the identity of the appellant or appellants."[4] *Torres*, 108 S. Ct. at 2409, and thus serves the same function as would a notice of appeal executed in the more technically proper manner. Because the Consent Order specifies "the party or parties taking the appeal," it conforms to this court's requirement in *Kowaleski* that Fed. R. App. P. 3(c) be complied with in a "punctilious, literal, and exact"

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4. Appellees conceded at oral argument that, in light of the Consent Order, they were aware that the law firm and the Eddys intended to appeal the district court's order.

manner. *Kowaleski*, slip op. at 7. Moreover, by upholding the Consent Order as sufficient notice of appeal, we follow the Court's directive to construe the rule "liberally," and to avoid a construction that would allow "mere technicalities" to bar consideration of a case on the merits. *Torres*, 108 S. Ct. at 2408; *see also Foman v. Davis*, 371 U.S. 178, 181 (1962).

Finally, because we have concluded that the Consent Order operates as an effective notice of appeal, we need not address the Eddy defendants' additional argument that, because they were not named parties to the underlying action, they could reasonably have assumed that they did not fall within the wording of the rule requiring "the party or parties" to be named in the notice of appeal. *Cf. Torres*, 108 S. Ct. at 2409 (jurisdictional requirements may not be waived, even for "good cause shown" under Rule 2).

III.

We now turn to the merits of the district court's decision to impose Rule 11 sanctions in this case. We review *de novo* the district court's legal conclusion that the facts constitute a violation of the Rule, but review a challenge to the appropriateness of the Rule 11 sanction imposed under an abuse of discretion standard. *Snow Machines, Inc. v. Hedco, Inc.*, 838 F.2d 718, 724 (3d Cir. 1988)(citing *Zaldivar v. City of Los Angeles*, 780 F.2d 823, 828 (9th Cir. 1986)). As this court pointed out in *Snow Machines*, the exercise of the district court's discretion is directed more to the nature and extent of the sanctions, than to the initial decision to impose sanctions, which constitutes a legal determination subject to plenary review. *See* 838 F.2d at 725.

A.

Rule 11 provides, in part:

> [t]he signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include **an order to pay to the other party or parties the amount of the reasonable expenses incurred** because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

Fed. R. Civ. P. 11. Rule 11 sanctions may be imposed "'in the exceptional circumstance' where the claim or motion is patently unmeritorious or frivolous." *Doering v. Union County Bd. of Chosen Freeholders*, 857 F.2d 191, 194 (3d Cir. 1988)(citing *Gaiardo v. Ethyl Corp.*, 835 F.2d 479, 483 (3d Cir. 1987)). Although the Rule imposes a duty of reasonable inquiry as to both facts and law,[5] it is "not intended to

5. *See Gwaltney of Smithfield v. Chesapeake Bay Foundation, Inc.*, 108 S. Ct. 376, 385 (1987)("Rule 11 . . . , which requires pleadings to be based on a good-faith belief, formed after reasonable inquiry, that they are well grounded in fact, adequately protects defendants from frivolous allegations.").

chill an attorney's enthusiasm or creativity in pursuing factual or legal theories." Fed. R. Civ. P. 11 (advisory committee notes). The standard is one of "reasonableness under the circumstances."[6] *Id.*; *Gaiardo*, 835 F.2d at 482. The court must evaluate the signer's conduct "by inquiring what was reasonable to believe at the time the pleading, motion, or other paper was submitted," an evaluation which should depend on a variety of factors, including "whether the pleading, motion, or other paper was based on a plausible view of the law." Fed. R. Civ. P. 11 (advisory committee note). In *Gaiardo*, we cautioned that "[l]itigants misuse the Rule when sanctions are brought against a party whose only sin was being on the unsuccessful side of a ruling or judgment." 835 F.2d at 483; *see also Golden Eagle Distrib. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1540-41 (9th Cir. 1986)(district court may not impose sanctions simply because party's nonfrivolous argument is found by the district court to be unjustified).

Eddy & Osterman argue that their conduct is not properly subject to Rule 11 sanctions because the firm's decision to disregard the May 13 shareholder resolutions was based on a plausible view of the law. Citing § 1401 of the Pennsylvania Business Corporation Law[7] and *In re Penn Central Securities Litigation*, 367 F. Supp. 1158 (E.D. Pa. 1973), the

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6. Rule 11 was amended in 1983. The "reasonableness standard" of the amended rule "is more stringent than the original good faith requirement because it represents an objective, rather than a subjective, standard." Wright, Miller & Kane, 5 *Federal Practice and Procedure* § 1333 at 177 (Supp. 1987).

7. Section 1401 states that "[t]he business and affairs of every business corporation shall be managed by a board of directors . . . ." 15 Pa. Cons. Stat. Ann. § 1401 (Purdon Supp. 1988).

Eddy defendants claim that the May 13 shareholder resolutions were not binding on the corporation because, under Pennsylvania law, only a corporation's board of directors may manage the affairs of the corporation. Under this view, the shareholder resolutions of May 13 dismissing former counsel, retaining new counsel, and authorizing dismissal of the suit were actions taken *ultra vires*, a view which the law firm claims is supported in both statutory and case law and which is not "unmeritorious or frivolous." *See Doering*, 857 F.2d at 194. Because the board of directors of Dura Systems did not initiate or authorize the removal of Eddy & Osterman as counsel to the corporation, the firm claims that it had reasonable grounds to believe that it had continuing authority to pursue the law suit against Rothbury.

The district court found the firm's legal theory "dubious." *Dura Systems v. Rothbury*, No. 86-2621, mem. op. at 6 (W.D. Pa. October 11, 1988). "What concerns us, for the purposes of this motion, is the critical and indisputable fact that the shareholders, whether voting as shareholders (as they did) or as a board of directors (as Eddy & Osterman allege they should have done), decided by a two-thirds vote that this lawsuit, which was nominally brought on behalf of the corporation, should be dismissed." Mem. op. at 5-6. Because the district court concluded that the law suit against Rothbury, initiated and maintained by Eddy & Osterman, was unauthorized and "apparently unfounded in law and fact," the court held that "Eddy & Osterman . . . abused the litigative process to such a degree that the imposition of sanctions [was] warranted." *Id.* at 24.

The district court also noted, and Rothbury stresses in its brief, that the law firm's decision may have been motivated by self-interest. The district court concluded that, despite the firm's ostensible

representation of Dura Systems, it pursued the law suit to protect the interests of Thomas Eddy, minority shareholder in Dura Systems, and/or of his two sons, who were members of the Dura Systems board. In addition, Rothbury accuses the law firm of exercising deliberate and intentional control over the Dura Systems Corporation to the exclusion of the majority shareholders, claiming that (1) Thomas R. Eddy incorporated Dura Systems and named himself and his two sons directors without notice to the other shareholders; (2) the Eddy family board of directors ran Dura Systems to the complete exclusion of the other shareholders; and (3) the Eddy Board filed the complaint against Rothbury with the knowledge that the majority of shareholders had neither authorized the suit nor had been notified of its filing. Based on these allegations, Rothbury submits that Rule 11 sanctions were not only justified, it cross-appeals on the grounds that sanctions should have been imposed as of the date of the filing of the complaint against Rothbury.

B.

We cannot find that the Eddy defendants' conduct, either in filing the original complaint against Rothbury or in pursuing that cause of action on behalf of Dura Systems after the May 13 shareholders' meeting, justified the imposition of Rule 11 sanctions. Rather, we are constrained to conclude that the Eddy defendants' conduct, albeit arguably self-serving, was based on a "plausible view of the law" that is not "patently unmeritorious or frivolous."

First, with respect to the initial filing of the complaint, the Eddy-installed Board of Directors, as the lawfully appointed board under 15 Pa. Cons. Stat.

Ann. § 1210 (Purdon Supp. 1988),[8] ostensibly had the authority to file suit. Indeed, under the Dura Systems By-Laws, "[t]he business and affairs of the corporations shall be managed by its Board of Directors[,]" which "may exercise all such powers of the corporation and do all such lawful acts as are not by statute or by the Articles of Incorporation, or by these By-Laws directed or required to be exercised or done by the shareholders." App. 152a-53a. *See also* 15 Pa. Cons. Stat. Ann. § 1401 (Purdon Supp. 1988)("The business and affairs of every business corporation shall be managed by the board of directors . . . ."). In contrast, Rothbury cites no authority for the proposition that the Dura Systems Board lacked the authority to institute the underlying suit. Thus, Rothbury has not demonstrated on the cross-appeal that the Eddy defendants' initiation of suit against it, on behalf of Dura Systems, was based on an implausible view of the law or was unreasonable

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8. Section 1210 of the Pennsylvania Business Corporation Law states:

> § 1210 Organization Meeting
>
> After the filing of the articles of incorporation, an organization meeting of the board of directors named in the articles *or of the incorporators if no directors are named in the articles*, shall be held, either within or without this Commonwealth, at the call of a majority of directors or incorporators for the purpose of adopting by-laws which they shall have the authority to do at such meeting, *of electing directors if no directors are named in the articles*, and in the case of a meeting of the board of directors, of electing officers, and of transacting such other business as may come before the meeting. The directors or incorporators calling the meeting shall give at least five days notice of the time and place of the meeting.

15 Pa. Cons. Stat. Ann. § 1210 (Purdon Supp. 1988) (emphasis added).

under the circumstances.[9] Therefore, we find no justification for imposing Rule 11 sanctions as of the date of the filing of the complaint.

Further, we are unable to conclude that the Eddy defendants' perpetuation of the underlying law suit after the May 13 meeting constituted conduct so lacking in legal basis as to be "patently unmeritorious or frivolous." The Eddy defendants claim that the shareholder resolutions dismissing former counsel, retaining new counsel and authorizing dismissal of the suit were not binding on the corporation because they violated § 1401 of the Pennsylvania Business Corporation Law, which mandates that "[t]he business and affairs of the corporation shall be managed by the corporation . . . ."[10] *See* note 7 *supra*. In support, they cite *In re Penn Central Securities Litigation*, 367 F. Supp. 1158 (E.D.Pa. 1973), for the proposition that the board of directors, rather than the shareholders, control the conduct of litigation on behalf of the corporation. While this case more generally addresses, *inter alia*, the requirement that a shareholder seeking to press a claim on behalf of the company must first demand that the directors take the action desired, it also contains language that the directors, and not the shareholders, ordinarily conduct litigation on the corporation's behalf. 367 F. Supp. at 1163.

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9. If the Eddy family board of directors was motivated by self-interest in its management of Dura Systems, then presumably the shareholders may have a remedy.

10. As we have noted, John Eddy made the same objections at the May 13, 1987 shareholders meeting. At that meeting, the newly elected directors did not vote on these matters.

Whether we would decide in favor of the Eddy defendants is not relevant to the issue before us.[11] Even if the Eddy's legal arguments may be tenuous, we need only determine whether their positions are "patently unmeritorious or frivolous," *see Doering*, 857 F.2d at 194. It appears to us that in this case, the district court evaluated the Eddy defendants' position in terms of its potential for success on the merits. On balance, we cannot say their position was "patently unmeritorious or frivolous."

We will reverse the judgment of the district court. Each side to bear its own costs.

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11. The merits of the underlying case regarding the franchising agreement have been considered by this court on appeal. *Dura Systems v. Rothbury Investments Inc.*, No. 88-3520, mem. op. (3d Cir. Dec. 19, 1988). In the opinion, we assumed *arguendo* that the law firm had the authority to bring the law suit on behalf of Dura Systems.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX D

A 067 Filed October 16, 1989
FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 89-3005 and 89-3023

DURA SYSTEMS, INC.,
A Pennsylvania Business Corporation

Appellant in 89-3005

v.

ROTHBURY INVESTMENTS, LTD.,
A Canadian Corporation

Appellant in 89-3023

On Appeal from the United States District Court
for the Western District of Pennsylvania
(D.C. Civil Action No. 86-2621)

Argued July 17, 1989

Before: STAPLETON, SCIRICA and ROSENN,
Circuit Judges

ORDER AMENDING SLIP OPINION

IT IS HEREBY ORDERED that the slip opinion in the above case, filed September 19, 1989, be amended as follows:

1. Page 10, Part III, first paragraph: Delete first paragraph of Part III and substitute the following paragraph in lieu thereof:

> We now turn to the merits of the district court's decision to impose Rule 11 sanctions in this case. "Our review of the imposition or denial of sanctions under Rule 11 is limited to determining whether the district court has abused its discretion." *Teamsters Local Union No. 430 v. Cement Exp., Inc.*, 841 F.2d 66, 68 (3d Cir. 1988); *Gaiardo v. Ethyl Corp.*, 835 F.2d 479, 485 (3d Cir. 1987). Our court has said that "the question is not whether the reviewing court would have applied the sanction, but whether the district court abused its discretion in doing so." *Snow Machines, Inc. v. Hedco, Inc.*, 838 F.2d 718, 724 (3d Cir. 1988); *Eavenson, Auchmuty & Greenwald v. Holtzman*, 775 F.2d 535, 540 (3d Cir. 1985). Under the circumstances in this case, we find an abuse of discretion.

2. Page 17, first paragraph: Delete first paragraph on page 17 and substitute the following paragraph in lieu thereof:

> Whether we or the district court would decide in favor of the Eddy defendants is not relevant to the issue before us.[11] Even if the Eddys' legal arguments may be tenuous, the district court need only determine whether their positions are "patently unmeritorious or frivolous," *see Doering*, 857 F.2d at 194. It appears to us that in this case,

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11. The merits of the underlying case regarding the franchising agreement have been considered by this court on appeal. *Dura Systems v. Rothbury Investments, Inc.*, No. 88-3520, mem. op. (3d Cir. Dec. 19, 1988). In the opinion, we assumed *arguendo* that the law firm had the authority to bring the lawsuit on behalf of Dura Systems.

the district court evaluated the Eddy defendants' position in terms of its potential for success on the merits. Under the circumstances in this case, we believe this constitutes an abuse of discretion.

BY THE COURT,

/s/Anthony J. Scirica

Dated: October 16, 1989

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit